Q&A: Ted Zangari & Jaime Reichardt

(A big) opportunity knocks

Ted Zangari, chair of the Redevelopment Law Practice Group at Sills Cummis & Gross P.C. in Newark. *– SILLS CUMMIS & GROSS P.C.*

Why Sills Cummis' attorneys feel Opportunity Zone program could bring 'greatest wealth transfer in history of country'

BY TOM BERGERON
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Ted Zangari, chair of the Redevelopment Law Practice Group at **Sills Cummis & Gross P.C.** in Newark, is one of the most prominent public incentives and real estate attorneys in the state. His law firm colleague **Jaime Reichardt** chairs the firm's state and local tax practice and has advised clients on all sorts of complicated federal and state taxation issues.

While others are still waiting for more details on the recently enacted Opportunity Zone program — a federal program co-sponsored by U.S. Sen. **Cory Booker** (D-N.J.) — Zangari and Reichardt have made it clear that they and Sills Cummis are all in.

"This program has the potential to be the greatest wealth transfer in the history of this country," Zangari told ROI-NJ. "Certainly, in a generation. I know that's a bold statement, but there are trillions of dollars in appreciated assets sitting on the sidelines waiting for a better investing opportunity."

Zangari and Reichardt recently shared their thoughts with ROI-NJ:

ROI-NJ: *Let's start at the beginning. So many people are still confused about the Opportunity Zone program. How will people invest in Opportunity Zones?*

Jaime Reichardt: In a nutshell, here's how the Opportunity Zone program will work, and bear in mind that the **IRS** has not yet promulgated regulations, so we're all waiting for clarity on a raft of issues.

A taxpayer sells an appreciated asset and within 180 days invests some or all of the proceeds in a Qualified Opportunity Fund, which are specifically organized to make investments in the zones. The fund can be a third-party fund or the investor can create its own self-directed fund. The fund, in turn, must invest at least 90 percent of its assets in a property or business within an Opportunity Zone — a qualifying federal census tract or 'deep poverty pocket' in which more than 20 percent of the residents live below the poverty level.

ROI: *How is it different from the 1031 exchange, where real estate investors can roll over gains into other properties to avoid paying taxes.*

Ted Zangari: A 1031 exchange is limited to the sale of real estate and no other kind of appreciated asset, and the sole tax benefit is the deferral of the capital gain by purchasing like-kind real estate. In contrast, the Opportunity Zone program allows for the sale of any property, including stock, bonds, land, equipment or other capital assets, and it offers not only a tax deferral on the capital gain, but also a tax reduction and permanent tax exemption on the new investment. I'll explain.

The first tax benefit is the tax deferral. The gain on the sale of the appreciated asset is deferred until Dec. 31, 2026, when it will be recognized and taxed. This is the one feature of the program that is less tax advantageous than a 1031 exchange, which allows for the perpetual rollover of a gain if similar replacement property is held by the taxpayer.

Next up, is the tax reduction. When taxes are paid in 2026 on the original sale, the capital gain that's subject to tax is cut by 10 percent if the investment has been held in the fund for five years prior to the end of 2026 and by 15 percent if seven years have elapsed. Finally, and this is the best part, if the investment in the fund is made by the end of 2026 and held for 10 years, the taxpayer receives the benefit of having a stepped-up basis equal to fair market value on the new investment when it is sold. In other words, an investment held for more than 10 years can be sold tax-free.

This last benefit alone is why our clients are calling the program a '1031 exchange program on steroids.'

ROI: *How much money is out there to potentially be invested?*

TZ: Sen. Booker puts the number at $6 trillion. He's not far off from the **Economic Innovation Group**, which estimates that U.S. households held an estimated $3.8 trillion of unrealized capital gains in stocks and mutual funds alone at the end of 2017, and corporations held another $2.3 trillion. Those estimates could be low. Just consider the number of high net worth families led by steadily retiring baby boomers, especially in cases where the next generation doesn't want to continue a family-owned business or is searching for a more diverse investment portfolio.

ROI: *Let's talk taxes, which is a key component in all of this. They are not all avoided, correct?*

JR: No, not all taxes are avoided. As Ted noted, the first tax benefit is the deferral of the invested capital gain, which is not indefinite. The taxman must be paid on the earlier of when the interest in the fund is sold by the investor or Dec. 31, 2026. If the Opportunity Fund interest is held for five years, the deferred gain is reduced by 10 percent, through a basis adjustment, when it's recognized and taxed. If the interest is held for seven years or more, the deferred gain is reduced by 15 percent when it's recognized and taxed. And finally, the real sweetener is when the investor holds the Opportunity Fund interest for 10 years or more — in this case, there is no gain on the sale of the interest through a step-up in basis equal to fair market value. Standard tax rules would apply with respect to any ordinary business income earned by the fund during the 10-year holding period.

The big question is whether states will conform their tax codes to the Opportunity Zone benefits. If our state fails to do so, and other states do, New Jersey will have squandered a once-in-a-lifetime opportunity to rebuild deeply impoverished sections of our cities and rural communities, because investors will gravitate to states that match the federal tax treatment.

ROI: *OK, let's get specific to New Jersey. There are 169 Opportunity Zones in the state. Are some better than others? How do you know where to invest?*

TZ: The zones are located in 75 municipalities, and every county has at least one zone. They represent a quarter of the state's 'deep poverty pockets' that I described earlier.

Certainly, there will be projects that are more attractive than others, but to hear Gov. (**Phil**) **Murphy** explain it, his administration was very methodical in nominating zones to the federal government. From what we've seen so far, the state did in fact pick many zones where projects could actually happen — meaning zones located in or near transit hubs, universities, airports and seaports. Of course, those areas may also command a higher cost premium for acquisition, so there may be a bigger bang for the investor's buck and a potential boom in zones that are less developed. Think of all the existing manufacturing businesses in rust-belt sections of our state and farming, winery and microbrewing operations in rural New Jersey that are ready to expand in place with the infusion of Opportunity Fund investment dollars.

ROI: *You talk about growing areas. Does the money have to be invested in new development?*

TZ: No. Most people are assuming that the investment must be placed into a real estate project, but an investment into a business located within a zone will also be permitted. We are all awaiting on further guidance and regulations from the U.S. Treasury, but as of now, a Qualified Opportunity Fund can own interests in a business with substantially all of its tangible property being Qualified Opportunity Zone Property, which is tangible property that is either first used in the zone or substantially improved, as Jaime explained earlier.

ROI: *How is the real estate group at Sills Cummis, which you co-chair, approaching this?*

TZ: First, we set up a war room months ago, where we've been going city-by-city, town-by-town, census tract-by-census tract and figuring out if any of our existing clients own properties within those zones. And, if not, which properties in those zones make for great investments either by our fund clients looking to create Opportunity Zone funds, or our redeveloper clients, who would do a project in one of those zones if equity investments were easier to obtain.

Second, we formed a multidisciplinary practice group dedicated toward assisting with setting up Qualified Opportunity Funds and facilitating investment transactions into or out of OZ funds on behalf of the investor, or the fund manager, or the redevelopment project or business receiving those investments. The practice group is comprised of tax, real estate, corporate, securities regulation and public finance attorneys.

Jaime Reichardt, of Sills Cummis & Gross P.C., chairs the firm's state and local tax practice.

Unlike state incentives work, this federal program is borderless — meaning, we can follow our national real estate investor, fund and redeveloper clients, and our multifacility business clients across the country. I saw the transformative national potential of this program early on. In May, I participated on a panel with the mayor of Baltimore at the international shopping center convention in Las Vegas. Most audience members — sophisticated shopping center developers and bankers — did not have even a basic understanding of the program nearly six months after its enactment.

To fill the information gap, we recently launched a law blog specifically on the topic. It's at federalopportunityzonelaw.com. The response has been overwhelming, to say the least.

ROI: *So, should we expect massive amount of funding in the coming weeks and months?*

JR: We are expecting a fairly significant amount of funding in the coming weeks, prior to the issuance of regulations and guidance, mainly from entrepreneurs. Then, there may be a bit of a stall and education process to get used to the new regulations. After that, if implemented properly, we would expect an even greater uptake in funding, including massive investments from Wall Street.

So, it's going to take some time. The bigger investors and redevelopers are going to want to see how the regulations shake out. This is going to start like most other things, with entrepreneurs who rush in and take advantage of the program because they have bite-sized deals that can be done quickly and without complications.

But there are built-in motivators that will spur all interested parties to move quickly. Since taxes on the original gain must be paid in 2026 and the available tax cut on that amount requires a five- or seven-year holding period, the program will begin to lose some luster after 2021. Also, sale proceeds must be invested in a fund within 180 days and the fund must substantially improve the subject property within a 30-month period.

ROI: *We hear talk about making changes to other incentive programs. Will Opportunity Zones make programs such as Grow New Jersey obsolete?*

TZ: They're apples and oranges. Grow New Jersey is a stipend to level the cost-differential between locations when a business is comparing a more expensive New Jersey location with a lower-cost location out of state that is under consideration. Opportunity Zones can complement our state incentive in the sense that more and less expensive location options may become available on currently underutilized and overlooked sites.

Make no mistake about it. As long as New Jersey is surrounded by lower-cost states, in terms of property taxes, income and business taxes, utility rates, etc., with comparable attributes in terms of available workforce, transit connectivity, etc., a state financial incentive will be required.

ROI: *What does the new program mean for Sen. Booker's political prospects and policy agenda?*

TZ: The Opportunity Zone program could be Sen. Booker's legacy and possibly his ticket to the White House. If implemented properly at every level of government, beginning with common-sense and flexible regulations out of the **U.S. Treasury**, the Opportunity Zone program could be as powerful an economic stimulator as the Civilian Conservation Corps was under the FDR administration.

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